INDIANA DEPARTMENT OF STATE REVENUE

RULING #1999-07IT

October 1, 1999

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ISSUE

Adjusted Gross Income Tax, Supplemental Net Income Tax and Gross Income Tax – Nexus

Authority: IC 6-3-2-1, IC 6-3-2-2(a), Rule 45 IAC 3.1-1-38, IC 6-3-8-2, IC 6-2.1-2-2, Rule 45 IAC 1.1-1-3, Rule 45 IAC 3.1-1-53, Rule 45 IAC 1.1-3-3

The taxpayers request the Department to rule on whether or not they have nexus in Indiana for adjusted gross income tax, supplemental net income tax and gross income tax purposes.

STATEMENT OF FACTS

There are four entities that currently comprise the family of entities ("the Taxpayers"):

1. Taxpayer #1 is the original entity and has historically acted as the employer and is the legal contractor of expenses on behalf of the related entities. This company currently operates as an S corporation.
2. Taxpayer #2 was formed some six years ago to allow certain executives to acquire an equity interest in product lines added after their employment.
3. Taxpayer #3 was formed to acquire a company's lines and was used as a vehicle to give a group of investors a controlling interest (51 percent) in the respective product lines.
4. Taxpayer #4 was formed to acquire a company's lines and operates as a C corporation.

Each of the Taxpayers own trademark rights to various consumer product lines (typically "drug store" products). Each entity contracts with third party manufacturers to have its inventory produced. Each entity has its inventory sent to the Taxpayers' common public warehouse. While each of the entities above have substantially similar business operations, each of the entities has a different mix of investors and each entity owns its own respective trademark rights and product lines.

Historically, the Taxpayers have based their operations exclusively in Wyoming. Currently, the Taxpayers are restructuring their operations so that much of the administrative services historically performed in Wyoming will be performed in Connecticut by a newly formed corporation ("ServicesCo"). Such entity would perform "common services" on behalf of all four entities and charge such services out accordingly. The business purpose of ServicesCo is to more efficiently incur and distribute the common costs that relate to all four of the Taxpayers.

Costs and operations directly attributable to each of the Taxpayers are contracted by and invoiced to such companies. Raw materials and finished goods inventories are owned by the respective Taxpayers. Historically, the common public warehouse has been located in one or two states, but not Indiana. As a result of their expanding business, the Taxpayers are looking to consolidate their two public warehouses into one public warehouse that is strategically located to provide an efficient logistical delivery to their customers.

To facilitate the public warehouse contract, the Taxpayers propose to establish InventoryCo, a C corporation. The business purposes of InventoryCo would be to coordinate in a common entity the warehousing and logistical distribution processes of all four Taxpayers into a single entity. InventoryCo would: 1) contract with the public warehouse, 2) acquire and hold title to finished goods inventories, 3) maintain inventory records, 4) maintain shipping records, 5) allocate and dispurse the common and specific costs associated with receiving, storing and shipping the inventory to each of the Taxpayers based on a reasonable basis agreed to by each of the Taxpayers, and 6) direct the public warehouse to dropship all of its sales to the customers of the Taxpayers in accordance with the Taxpayers' instructions, and 7) invoice the Taxpayers for the inventory. The transfer price that would be charged to the Taxpayers would be determined consistent with intercompany pricing principal of Internal Revenue Code section 482 considering all factors including cost of inventory, time value of money, cost of storage and handling, and the relative risks associated with the assumption the business activities described above. In this capacity, InventoryCo would not: 1) have the right to sell the inventory in its possession to any party except the respective Taxpayer that owns the corresponding trademark rights to such product, 2) maintain separate facilities other than its "deemed" facilities at the premises of the independent public warehouse. InventoryCo may: 1) employ its own respective staff or contract with ServicesCo and the public warehouse to perform activities necessary to fulfill its contractual obligations with the Taxpayers.

DISCUSSION

IC 6-3-2-1 imposes adjusted gross income tax on adjusted gross income derived from sources within Indiana. IC 6-3-2-2(a) provides that adjusted gross income derived from sources in Indiana includes income from "doing business" in Indiana. Rule 45 IAC 3.1-

1-38, interpreting IC 6-3-2-2, provides that for apportionment purposes, a taxpayer is "doing business" in Indiana if it operates a business enterprise or activity in Indiana including, but not limited to:

1. Maintenance of an office or other place of business in Indiana;

2. Maintenance of an inventory of merchandise or material for sales, distribution, or manufacture, or consigned goods.

3. Sale or distribution of merchandise to customers in Indiana directly from company owned or operated vehicles where title to goods passes at the time of sale or distribution;

4. Rendering services to customers in Indiana;

5. Ownership, rental or operation of a business or of property (real or personal) in Indiana;

6. Acceptance of orders in Indiana; and

7. Any other act in Indiana which exceeds the mere solicitation of orders so as to give the state nexus under P.L. 86-272 to tax its net income.

IC 6-2.1-2-2 provides that gross income tax is imposed upon the receipt of taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer. Rule 45 IAC 1.1-1-3 defines "business situs", which if established by a taxpayer, gives nexus to the taxpayer in Indiana and subjects the taxpayer to gross income tax.

Rule 45 IAC 1.1-1-3 states:

> (a) A "business situs" arises where possession and control of a property right have been localized in some business or investment activity away from the owner's domicile.
> (b) A taxpayer may establish a business situs in ways, including but not limited to, the following:
> (1) Use, occupancy, or operation of an office, shop, construction site, store, warehouse, factory, agency route, or other place where the taxpayer's affairs are conducted.
> (2) Performance of services.
> (3) Maintenance of an inventory or stocks of goods for sale, distribution, or manufacture.
> (4) Sale or distribution of merchandise from company-owned vehicles where title to the goods passes at the time of sale or distribution.
> (5) Acceptance of orders without the right of approval or rejection in another state.

(6) Ownership, leasing, rental, or other business activities connected with income-producing property (real or personal).
(7) Ownership (in whole or part) of a partnership doing business in Indiana unless the ownership is that of a limited partner who does not participate in the control of the business.
(8) Other business or investment activities, other than de minimis, performed on behalf of the taxpayer by an employee of the taxpayer. These activities shall be considered together, not in isolation, in deciding if they are de minimis.

The taxpayers' activities will not fall within the ambit of the above statutes and regulations if they limit their activities in Indiana to solicitation and other activities in Indiana specifically protected by Public Law 86-272 and do not establish a "business situs" in Indiana. This includes not holding title to inventory in Indiana, unless the inventory is in the "commerce stream" or is entering the commerce stream (i.e. in transit via drop shipments). In the instant case then, to the extent the taxpayers satisfy the above requirements the taxpayers will not be subject to Indiana adjusted gross income tax, supplemental net income tax (IC 6-3-8-2) and gross income tax.

Conversely, InventoryCo's activities in Indiana will fall within the ambit of the above statutes and regulations giving InventoryCo nexus in Indiana for adjusted gross income tax, supplemental net income tax and gross income tax purposes. Based on the information furnished by the Taxpayers, InventoryCo specifically will be subject to "throwback sales" for adjusted gross income tax (Rule 45 IAC 3.1-1-53) and supplemental net income tax (IC 6-3-8-2) purposes, and drop shipments made in Indiana for adjusted gross income tax (Rule 45 IAC 3.1-1-38), supplemental net income tax (IC 6-3-8-2) and gross income tax (Rule 45 IAC 1.1-3-3) purposes.

The Taxpayer and InventoryCo are advised to contact the Department for an updated ruling if the facts and circumstances contained in this ruling change.

RULING

The Department rules that the Taxpayers will not have nexus in Indiana for adjusted gross income tax, supplemental net income tax and gross income tax purposes.

The Department, further, rules that InventoryCo will have nexus in Indiana for "throwback sales" for adjusted gross income tax and supplemental net income tax purposes, and drop shipments made in Indiana for adjusted gross income tax, supplemental net income tax and gross income tax purposes.

CAVEAT

This ruling is issued to the taxpayer requesting it on the assumption that the taxpayer's facts and circumstances, as stated herein, are correct. If the facts and circumstances given are not correct, or if they change, then the taxpayer requesting this ruling may not rely on it. However, other taxpayers with substantially identical factual situations may rely on this ruling for informational purposes in preparing returns and making tax decisions. If a taxpayer relies on this ruling and the Department discovers, upon examination, that the fact situation of the taxpayer is different in any material respect from the facts and circumstances given in this ruling, then the ruling will not afford the taxpayer any protection. It should be noted that subsequent to the publication of this ruling, a change in a statute, regulation, or case law could void the ruling. If his occurs, the ruling will not afford the taxpayer any protection.

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